2002

Termination of partnership: Crow Irvine #2 v Winthrop Cal. Investors, 2002

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Right of termination of partnership agreement, which required good faith belief in irreconcilable differences between partners, is measured by subjective standard, not objective standard.


In 1985, Winthrop and Crow entered a real estate development limited partnership that provided for termination “if either partner believes in good faith that irreconcilable differences between the Partners prevent the Partnership from achieving its purposes. . . .” Over the years, the partners sued each other seven times over matters such as access to partnership records and breach of fiduciary duty. In 2000, when Crow rejected Winthrop’s attempt to invoke the termination provision of the partnership agreement, Winthrop sued for declaratory relief. The trial court determined that Winthrop’s “good faith belief” that irreconcilable differences were preventing the partnership from achieving its purposes must be measured by an objective standard; on that basis, the court refused to grant relief because it found that the partnership was achieving its purposes.

The court of appeal reversed, holding that the “good faith belief” standard requires evaluation of a party’s subjective state of mind, without regard to whether the belief is objectively reasonable. The court remanded for determination of whether the surrounding circumstances (e.g., Winthrop’s own conduct and the reasonableness of the purported belief) indicated that Winthrop honestly believed what it professed. The court also found that the trial court had erred in holding that the partnership’s “purposes” had been achieved; the issue was whether Winthrop believed, in good faith, that they had not been achieved. The court, therefore, also remanded for determination of that issue.

**THE EDITOR’S TAKE:** In commenting on *Storek & Storek, Inc. v Citicirop Real Estate, Inc.* (2002) 100 CA4th 44, 122 CR2d 267, last year (see *(When) Am I My Borrower’s Keeper? Good Faith and Loan Workouts*, 25 CEB RPLR 186 (Sept. 2002)), I opined that, for a lender thinking about cutting off a borrower in default, objective reasonableness might be a safer standard than subjective good faith, because the mere existence of the default almost automatically satisfies a reasonableness standard, whereas good faith might be breached by the fact that the lender was looking out only for its own interests rather than the borrower’s.

*Crow Irvine* shows that as far as partnerships, rather than loans, are concerned, a subjective standard may be more appropriate. Dissolving a floundering partnership is not the same thing as calling a delinquent loan. Under a reasonableness standard, a trial judge could conceivably second guess and reject Winthrop’s decision to terminate the partnership on the ground that, in a similar position, he (the judge) would have stayed on as a partner; but, under a good faith test, the question would be whether he believed the partner’s
testimony about its motives for terminating, rather than reevaluating the wisdom of that decision.

Is good faith such a low standard that it could make the agreement illusory? There is no suggestion of that in the opinion. Good faith may seem self-proving in dissolution cases—no one is going to say in bad faith that he dislikes somebody that he really does like—but one can nevertheless think of situations where a judge can disbelieve the terminating partner’s testimony about its motive, *e.g.*, where the enterprise has done well and there has been no past bickering, but the partner has suddenly received an invitation to go into a more attractive venture elsewhere.

Of course, to decide whether you prefer a good faith or a reasonableness standard requires you to be able to predict whether you will be the one trying to withdraw later on rather than the one trying to stop the withdrawal of the other. Depending on your enthusiasm for the venture, that may be foreseeable. But then, that may only push the issue back a step to whether you acted in bad faith in bargaining for a clause that allowed you to act unreasonably, so long as you did so in good faith. —*Roger Bernhardt*